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DEVELOPMENT OF HUNGARY'S CREDIT SYSTEM AND THE HUNGARIAN NATIONAL BANK

[Numbers in parentheses refer to appended sources.]

Development of the Hungarian National Bank After Liberation

The financial authorities recently conducted a thoroughgoing investigation into the activities of the Hungarian National Bank. In view of the important results of the investigation, the Council of Ministers reviewed the bank's tasks in connection with the financial management and payment discipline of enterprises and stated the measures which would advance the fulfillment of these tasks.

During the first years after liberation, the bank solved important problems in credit extension and foreign exchange management. For example, by extending credit to private enterprises and the state during the period of inflation, it gave substantial impetus to normal economic activities. Later, it defended the stability of the forint by a selective credit policy.

Concomitantly, by introducing the single-account system, the bank established the basis for a nationwide supervision of enterprise management. As a result, it became the national center of credit extension and currency circulation. Its new powers enabled it to regulate the bank note circulation. At the same time, its powers and obligations in foreign exchange management were redefined. To cope with these new tasks, the bank was reorganized.

Insolvencies and New Credit Regulations

After its nationalization, the main task of the Hungarian National Bank in the field of credit extension was to assure continuity in production. First, it introduced the system of compulsory credit extension, thereby enabling insolvent, poorly managed enterprises to obtain credit automatically.

At the initial stage, this system was well conceived, because the socialized enterprises needed financial assistance. By the end of 1951, however, the finances of these enterprises were sufficiently consolidated to abolish the system. Moreover, abolition of the system was timely, since compulsory credits retarded the development of independent enterprise management, handicapped thriftiness, and encouraged laxity in financial discipline.

The credit reform carried out in 1951 and 1952 abolished the system of compulsory credits and laid the foundation of the application of the principles of sound credit extension, based on plan fulfillment, the purpose of the credit applied for, and the establishment of a sufficient credit balance by the due date of an indebtedness. Planned credit management and guidance of enterprise managements by credit extension thereby became firmly established.

Under the influence of the new system, favorable results were obtained in improved economy and financial discipline. A radical improvement, however, failed to follow. The disappointing outcome was due to a combination of causes: the Hungarian National Bank failed to enforce all its powers in credit discipline, and the enterprises and ministries were interested almost exclusively in the quantitative fulfillment of the production plans.

In essence the basic deviation of the new credit system from the old one lay in the fact that, when an enterprise showed unbudgeted losses, surplus inventories, or deficits contrary to its plan, the Hungarian National Bank refused to extend credit. This system, while sound in theory, resulted in widespread insolvencies, because the enterprises ignored the demands of economy and

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concentrated all their efforts on quantitative plan fulfillment. The insolvency of poorly managed enterprises had widespread repercussions, and a large number of other enterprises fell into serious financial difficulties. Also, the enterprises became burdened with heavy interest payments on their overdue indebtedness.

The basic causes of insolvency were failure to reduce production costs, surplus inventories, unauthorized investments and renovations, and general financial indiscipline. The rigidity of the budget system presented another serious problem. Some enterprises failed to achieve the planned profit but were nevertheless required to pay it over to the Treasury in monthly installments. As a result, millions of forints had to be refunded to the enterprises at the end of every quarter. Such mechanical interpretation led to bureaucracy and inflated the national budget.

Since insolvency is mostly caused by poor enterprise management, the Hungarian National Bank's view that the faults should be investigated and that credit retrenchment or financial assistance should be applied was sound. Yet, the bank pursued an entirely identical credit policy in regard to both well-managed and poorly managed enterprises.

In connection with the reduction of production costs, the bank considered the detection and liquidation of faults its principal task. Here again, however, it failed to treat the well-managed and poorly managed enterprises differently in the matter of credit policy.

The bank had better success in intervening in the detection and disposal of surplus inventories. In the course of investigations conducted by the bank, surplus stocks representing more than 2 billion forints were discovered in 1954. Half of this stock has already been disposed of.

The bank took the sound initiative of extending short-term credits to the enterprises for minor investments, changes in production methods, the introduction of economy measures, and cost reduction purposes.

Defects appeared in the implementation of the agricultural credit policy also. The producer cooperatives were supplied with the necessary credits but, because some of them were poorly managed, a large proportion of the credit extended had the character of a subsidy.

Liquidation of the mistakes which the Hungarian National Bank committed in the formulation and application of its credit policy is an urgent task. The main principles and measures for complying with this task were laid down in a resolution of the Council of Ministers as follows:

One of the primary tasks of the Hungarian National Bank is to work for the fulfillment of the 1955 national economic plan. In this endeavor the fulfillment of production cost reduction plans and the observance of financial discipline constitute the foremost tasks. By the application of a proper credit policy, the accumulation of new surplus stocks must be prevented. The bank's principles of credit extension accord with the economic policy of the party and government. A more active intervention in enterprise management is required, however.

A discriminatory credit policy as between well-managed and poorly managed enterprises must be pursued. The bank should extend increased assistance to well-managed enterprises and focus its control activities on poorly managed enterprises. If a well-managed enterprise becomes insolvent for reasons beyond its control, emergency credit may be extended for a period of 20 days for raw material purchases and for 30 days for the payment of payrolls.

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The bank is authorized to impose special conditions for credit extension on enterprises which systematically fail to fulfill their production, production-cost-reduction, and profit plans. In such cases, the bank will extend credit only if the supervisory organ of the enterprise guarantees the discontinuance of defects. The resolution thereby increases the financial responsibilities of the supervisory organs. If the supervisory organ refuses to assume the guarantee, the bank may decline the extension of credit to the enterprise concerned.

Credit to such an enterprise may then be extended only on the basis of its outstanding accounts receivable. The enterprise concerned is required to open accreditives and to provide cover in advance for checks issued. If the operations of the enterprise fail to improve by a target date set, more stringent measures may be taken, such as complete stoppage of credit extension and sale of certain enterprise assets by the bank for the satisfaction of outstanding credits. To carry out this task, the bank supervises the fulfillment of production, merchandise-turnover, and stockpiling plans; production cost reduction; the utilization of working capital; and payment discipline.

To avoid the unnecessary movement of funds, the resolution provides for the preparation and introduction of a method whereby the enterprises would have to make monthly payments to the Treasury of actual profits only. The resolution also states that the financial authorities should carry out a general settlement of enterprise indebtedness in the near future. This means that the combined indebtedness of all insolvent enterprises will be liquidated to the debit of the national budget, an action which will facilitate the transition to the new system.

Cashless Payments

As a result of the introduction of the single-account system, 90 percent of the payments are effected by cashless transactions. It should be noted, however, that the volume of cashless payments has been expanded by forced means. Over 30 varieties of cashless payment methods were created, and the maximum of cashless payments between nationalized enterprises was originally fixed as 100 forints, although this limit was raised to 500 forints in January 1955.

The overexpansion of cashless transactions increased the Hungarian National Bank's administrative apparatus and slowed down the velocity of currency circulation. Aside from the deficiencies mentioned above, however, the bank's efforts to step up currency circulation have been successful. Control of currency circulation was organized largely through the supervision of cash plans of the enterprises. This supervision enables the bank to control enterprise inventories and the national purchasing power and to analyze the currency circulation.

New Organs of the Hungarian National Bank

The Hungarian National Bank has kept abreast of economic developments, built up a far-flung branch network, and reorganized its central administration. Since the Council of Ministers has transferred the guidance of credit extension and currency circulation to the bank, a Plan and Statistical Directorate (Tervezési és Statisztikai Igazgatóság) and an Agricultural Credit Directorate (Mezőgazdasági Hiteligazgatóság) have been created. (1,2)

Currently there are three types of cashless payment systems in Hungary, all handled by the Hungarian National Bank. In the so-called collection system, bills receivable are submitted to the bank, which then acts as a collecting agent. The number of payments under this system increased by 500,000 and the amount by 330 percent from January 1950 to December 1954.

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The second system is known as the planned payment system and is generally used where a buyer and a seller transact business with one another on a continuing basis. In this case the buyer disposes of, and collects for, the goods purchased without delay. The system works smoothly and increases the velocity of currency circulation.

The third system works through the establishment of clearing accounts. It was introduced 2 years ago and has been confined to enterprises operating in the same field. Now that most enterprises are operating more efficiently, this payment system will be widely adopted. Regional clearing centers will be established: this means that the payments of all enterprises transacting business with one another and belonging to the same regional office will be handled by the same regional clearing center. (2)

SOURCES

1. Penzugyi Szemle, Vol II, No 4, Apr 1955; by Janos Szep, "collaborator" of the Central Committee of the Hungarian Workers Party
2. Ibid., No 6, Jun 1955; by Janos Voros, First Deputy Minister of Finance and Director General of the Hungarian National Bank

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